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# Interaction of Cyclical and Structural Systemic Risks: Insights from Around and After the Global Financial Crisis

Martin Hodula, Jan Janků, and Lukáš Pfeifer \*

## Abstract

We investigate the extent to which various structural risks exacerbate the materialization of cyclical risk. We use a large database covering all sorts of cyclical and structural features of the financial sector and the real economy for a panel of 30 countries over the period 2006Q1–2019Q4. We show that elevated levels of structural risks may have an important role in explaining the severity of cyclical and credit risk materialization during financial cycle contractions. Among these risks, private and public sector indebtedness, banking sector resilience and concentration of real estate exposures stand out. Moreover, we show that the elevated levels of some of the structural risks identified may be related to long-standing accommodative economic policy. Our evidence implies a stronger role for macroprudential policy, especially in countries with higher levels of structural risks.

## Abstrakt

V tomto článku zkoumáme, do jaké míry různá strukturální rizika prohlubují materializaci cyklického rizika. Využíváme rozsáhlou databázi pokrývající všechny druhy cyklických a strukturálních charakteristik finančního sektoru i reálné ekonomiky pro panel 30 zemí v období od 1. čtvrtletí 2006 do 4. čtvrtletí 2019. Dokládáme, že zvýšené hodnoty strukturálních rizik mohou hrát důležitou roli při vysvětlení závažnosti zhmotňování cyklického a úvěrového rizika během sestupné fáze finančního cyklu. Nejvýznamnější z těchto rizik se týkají zadluženosti soukromého a veřejného sektoru, odolnosti bankovního sektoru a koncentrace nemovitostních expozic. Dále ukazujeme, že zvýšené hodnoty některých identifikovaných strukturálních rizik mohou souviset s dlouhodobě akomodativní hospodářskou politikou. Naše poznatky implikují silnější úlohu makrobezpečnostní politiky, a to zejména v zemích s vyšší úrovní strukturálních rizik.

**JEL Codes:** E32, G15, G21, G28.

**Keywords:** Cyclical risk, event study, financial cycle, panel regression, structural risks, systemic risk.

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## 1. Introduction

Over the past two decades, financial markets have slowly gained prominence as a key factor driving real economic activity around the world. During the “Great Moderation” of 2003–2007, the global economy recorded its best performance of the past 50 years. However, this episode of record economic growth, accompanied by booms in the credit and housing markets, ended with the deepest financial crisis since the Great Depression. One of the buzzwords that emerged following the outbreak and propagation of the Global Financial Crisis (GFC) was the *financial cycle*. Since then, numerous studies have attempted to understand how the financial cycle affects the real economy (Borio, 2014), as well as to measure it (Drehmann et al., 2012) and control it (Galati and Moessner, 2013). Another buzzword that moved (back) into the limelight with the emergence of the 2007–2009 crisis was *systemic risk*, which has since become an important research topic (Hellwig, 2009; Haldane and May, 2011; Acharya et al., 2017).

Many policies have been put forward by academics, central banks, regulators and other policy makers in response to the GFC. One of the newly emphasized ones is macroprudential policy, which is tasked with increasing and maintaining the resilience of the banking sector, preventing build-ups of systemic risk and reducing the likelihood of crises and mitigating their impacts on the financial sector and the economy as a whole. At its core, macroprudential policy responds to developments in systemic risk in the financial sector. Systemic risk itself has two basic components recognised by the current literature: cyclical and structural risks. The cyclical component of systemic risk is related to the dynamic evolution of the financial cycle and can be represented, for example, by the credit-to-GDP gap (the “Basel gap”; Borio and Lowe, 2002; Borio and Drehmann, 2009; Detken et al., 2014). The structural component of systemic risk is related to the distribution of risks in the financial sector and has the potential to amplify adverse economic shocks. It is represented by various structural features of the financial sector and the real economy in general, such as the resilience and asset quality of the financial sector and the indebtedness of sectors of the real economy.

In this paper, we provide a comprehensive empirical overview of the relationship between cyclical risk and the structural characteristics of the financial sector and the real economy. We begin by assembling a large database covering all sorts of cyclical risks and various structural features of the financial sector and the real economy for a panel of 30 countries over the period 2006Q1–2019Q4. In our exploration, we focus on periods of cyclical risk *materialization* as represented by a recessionary phase of the financial cycle. We concentrate on the period surrounding and following the outbreak of the GFC, which also encompasses the eurozone debt crisis and other, more minor events. We take advantage of the endogenous nature of the financial and debt crises as well as benefiting from improved international data coverage over the past ten years.

We proceed by conducting a turning point analysis in which we identify turning points of the financial cycle (from peak to trough) for our sample of countries. In the process, we account for the intensity and length of the recessionary phase of the cycle. We then match the initial levels of various structural risks in the periods preceding peaks of the financial cycle to the extent of cyclical risk materialization. After examining broad cyclical risk indicators, we narrow the view and consider a subset of cyclical risk – credit risk, which we proxy by the non-performing loans to total loans ratio. The turning point analysis highlights several possibly stylized facts. Among other things, we find that countries with low banking sector resilience in the pre-crisis period experienced greater cyclical and credit risk materialization. We also find that the pre-crisis level of government debt is positively correlated with cyclical and credit risk materialization. Last, we find that countries with

low interest rates prior to the start of cyclical or credit risk materialization were also more indebted and had less resilient financial sectors.

These results set the stage for a more formal empirical analysis of the relationship between the cyclical and structural features of systemic risk. We employ panel regression models to analyse the importance of structural risks in explaining the degree of cyclical and credit risk materialization. We primarily find that the degree of cyclical and credit risk materialization is significantly associated with the indebtedness of sectors of the real economy, the concentration of real estate exposures (as measured by the share of real estate loans in total loans) and the resilience of the banking sector and the structure of the financial sector (bank-based vs. market-based). To account for the level effect of structural risks, we divide our sample of countries into high and low structural risk countries. We generally find the levels of individual structural risks before the outbreak of the GFC to be crucial for the strength of the empirical relationship between cyclical and credit risk materialization and structural risks. We show that the pre-crisis level of interest rates played an important role in the strength of the relationship between credit risk materialization and structural risks.

We contribute to several different strands of literature. First, we extend the literature on financial cycles along a few dimensions. We provide the first detailed, cross-country empirical analysis of the interplay between the evolution of cyclical risk and numerous structural risks. Moreover, we consider a more comprehensive sample of structural risks than is common in the existing literature. Furthermore, since we employ quarterly data rather than the annual data typically used in other cross-country studies (Bats and Houben, 2020; Ari et al., 2020), we can better identify and document the properties of systemic risk and its two components – cyclical and structural. Last, we take advantage of our large dataset and use a time-series approach on top of the regularly employed frequency and turning-point based methods (Stremmel and Zsámboki, 2015; Claessens et al., 2011, 2012). Second, we contribute to the literature studying the structure of the financial system and its implications for lending and economic growth (Langfield and Pagano, 2016; Bats and Houben, 2020). We enrich the analytical considerations of the role of the structure of the financial system with other characteristics that might be of importance, such as real estate exposure concentration and the level of indebtedness and the resilience of the banking sector. Third, we also contribute to the ongoing and vast analytical work on the macroprudential policy framework. Existing studies typically deal with the appropriate configuration of macroprudential policy tools (Hanson et al., 2011; Malherbe, 2020; Pfeifer and Hodula, 2021) and the early warning properties of different financial cycle indicators (Drehmann and Juselius, 2014; Babecký et al., 2014). Our empirical evidence allows us to draw relevant policy conclusions with regard to the design and implementation of macroprudential policy measures.

The remainder of this paper is structured as follows. Section 2 presents an overview of the literature on cyclical and structural systemic risks and discusses their interaction. Section 3 presents the data employed in the analyses. Section 4 gives the results of our turning point analysis and Section 5 introduces the results of our panel regression approach. The final Section 6 concludes.

## **2. Systemic Risk: An Overview**

Increases in systemic risk in the financial system give rise to a threat to financial stability. Systemic risk is generally defined as the risk of a serious failure occurring in the entire financial system or a part thereof, with undesirable impacts on the current and future development of the economy as a whole. In other words, growth in systemic risk implies an increase in the vulnerability of the entire financial system. It has two components - a cyclical one and a structural one. The cyclical

dimension is concerned with the build-up of macro-financial imbalances over the financial cycle, while the structural (cross-sectional) dimension is concerned with the build-up of systemic risk due to changes in the financial system.

In what follows, we describe each of the two parts of systemic risk in more detail, aiming to summarize the advances made in research in this area, to establish where our work fits into the literature and to highlight our contribution.

## **2.1 Cyclical Risk**

There is an emerging consensus in the academic literature that cyclical risk tends to build up gradually, well in advance of financial crises. It is thus associated with the financial cycle and the cyclicity of the financial system in general (see, for example, Minsky, 1982; Kindleberger et al., 1996). Typically, studies find that the average length of (financial) cycles arising from credit and asset prices is around 15–20 years (Aikman et al., 2015; Schularick and Taylor, 2012; Drehmann et al., 2012; Lang et al., 2019). In an upward phase of the financial cycle, credit growth and prices of financial assets and property rise sharply, against a backdrop of very relaxed financial conditions. In turn, the elevated asset prices increase the value of collateral and thus the amount of credit the private sector can obtain, until, at some point, the process goes into reverse. Unsurprisingly, peaks of financial cycles have historically tended to cause serious macroeconomic dislocations (Jordà et al., 2013; Mian et al., 2017). Claessens et al. (2012) show that recessions coupled with financial imbalances are lengthier and deeper than normal business cycle contractions.

Credit and house price indicators are among the oldest and most widely used indicators (Borio and Zhu, 2012; Aikman et al., 2015; BIS, 2017). A challenge in exploring the recurrent nature of the financial cycle is that each cycle differs noticeably over time (Figure A1). Furthermore, when looking at the longer time scale, one must not forget other structural changes in the economy, such as changes made to exchange rate, monetary, fiscal and regulatory regimes. Burnside et al. (2016) show that periods of financial repression, for example, have tended to influence the shape of the financial cycle. And while recurrent long swings in financial forces are evident, it might be tricky to compare financial cycles. For instance, Albuquerque et al. (2015) show that it might be better to focus on episodic, not conventional time series. This is the path we take in our paper, in which we concentrate on the period surrounding and following the Global Financial Crisis of 2007–2009.

## **2.2 Structural Risks**

A general feature of structural risks is their potential to amplify the impact of adverse economic shocks. As research indicates, the origins and depth of financial crises differ significantly, but they primarily reflect interactions between build-ups of cyclical imbalances and underlying structural risks (Liang, 2013). In what follows, we divide structural risks into two broad categories: (i) risks stemming from the structural characteristics of the banking sector and (ii) risks to the banking sector stemming from the real economy. Both of these risk categories can be broken down into several sub-categories. A detailed breakdown of structural risks is provided in Table 1, which is based partly on the ESRB (2014) approach and lists specific structural risks and relevant indicators.<sup>1</sup> Those highlighted in bold are used in our subsequent analyses; there is insufficient data coverage for the other indicators. The amplification channels are established, for example, through direct linkages between financial institutions, common exposures, similar business models, low resilience,

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<sup>1</sup> In addition, ESRB (2014) considers risks stemming from the propagation and amplification of shocks within the financial system. However, this is an inherent feature of all structural risks.

vulnerability of the private sector and pro-cyclical financial regulation (Gorton and Metrick, 2012; Liang, 2013; Aldasoro et al., 2017). Increased structural risks may contribute to deleveraging of the private sector, triggering a downward spiral of falling asset values and bank defaults through these channels during financial cycle contractions.

**Table 1: Structural Risks and Relevant Indicators**

Structural risks	Specific risks	Relevant indicators
Risks stemming from the characteristics of the banking sector	Structural characteristics of the banking sector	<b>Bank assets as share of GDP (%)</b> , <b>bank vs. market financial sector index</b> , systemic importance score
	Exposure concentration and commonality	Sectoral distribution of total loans (%), <b>concentration of real estate exposures (% of client exposures)</b> , share of large exposures in total assets (%)
	Asset quality	<b>Share of non-performing loans (%)</b> , coverage ratio (%)
	Resilience	<b>Capital ratio</b> , <b>leverage ratio</b> , <b>return on assets</b> , <b>liquid assets to total assets (%)</b> , LCR (%)
	Financial regulation and CB policy	<b>Level of aggregate risk weights (%)</b> , <b>3M Pribor</b>
	Ownership structures	Share of assets of subsidiaries and branches in total banking sector assets (%), net external position of banking sector (% of GDP)
	Cyber risks	Pillar 1 capital requirements for operational risk, share of non-banks in financial sector assets (%)
Risks to the banking sector stemming from the real economy	Indebtedness of real economy sectors	<b>Indebtedness of real economy sectors to GDP (%)</b> , <b>DSTI of non-financial private sector (%)</b>
	Economic openness	<b>Share of exports in GDP (%)</b> , current account to GDP (%)
	Risks associated with climate change	Share of credit exposures to climate change risk sectors (“dirty sectors”), (%)

**Note:** Own processing. The table presents a detailed list of structural risks and a wide range of relevant indicators. Those we use in our empirical analysis are indicated in bold.

The literature often focuses on the risk of high private or public indebtedness (or, in dynamic terms, underlying rapid credit growth) and shows that high debt can increase systemic risk and the likelihood of a financial crisis. Previous empirical studies have examined government debt crises and their relation to banking crises (Borio and Lowe, 2002) or financial crises in general (Manasse et al., 2003; Rose and Spiegel, 2012; Dawood et al., 2017). Hunt et al. (2015) shows that high and rapidly rising levels of household debt can be risky because they increase the sensitivity of households to a negative shock to their income or balance sheet. During periods of financial stress, highly indebted households tend to cut their spending more than their less-indebted peers. This is the amplification mechanism of cyclical risk materialization and explains the deep fall in GDP seen during the 2007–2009 crisis and the subsequent slow recovery. It should also be noted that higher

indebtedness and a lower share of liquid assets change the sensitivity of the response of households to monetary policy. Gelos et al. (2019) show that households with higher debt levels and lower shares of liquid assets are actually the most responsive to monetary policy.

Studies generally recognise that the course of financial crises is directly affected by certain structural characteristics of the financial sector or the economy in general. Allen et al. (2012) show that bank-based financial systems need more time to recover from an economic downturn following a financial crisis. Langfield and Pagano (2016) find that countries with bank-based financial systems exhibit higher systemic risk and lower economic growth, particularly during housing market crises. Bats and Houben (2020) reach a similar conclusion that bank-based financial structures are associated with higher systemic risk than market-based ones.

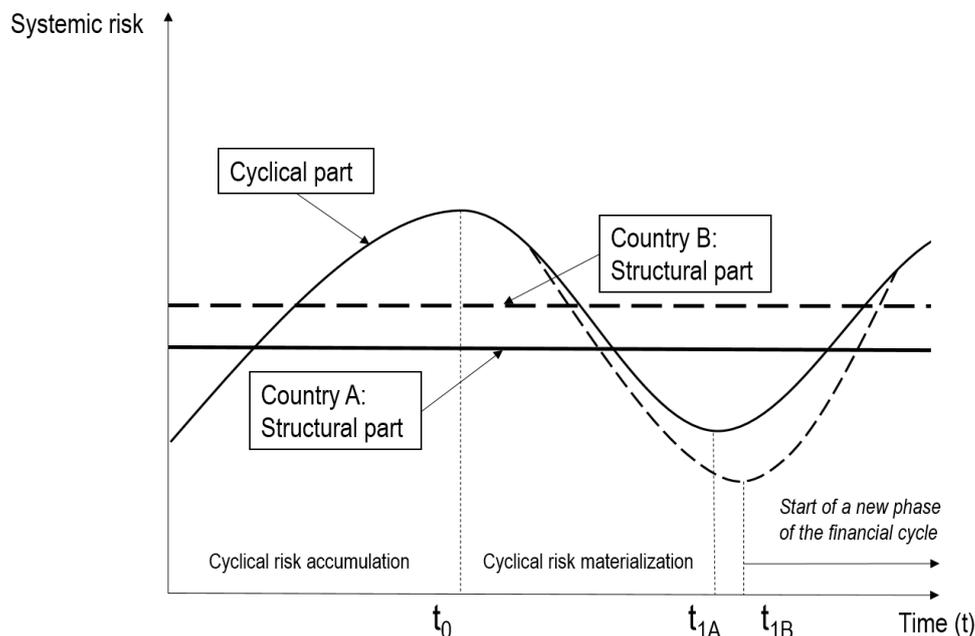
Current research points to the existence of certain structural risk thresholds above which the economy is more vulnerable. This issue is best described in relation to the level of indebtedness, both public and private. For example, Reinhart and Rogoff (2010) and Reinhart et al. (2012) suggest that there is a threshold effect whereby debt above 90% of GDP is associated with worse growth outcomes. Lombardi et al. (2017) suggest that there are negative long-run effects of debt on consumption and that these effects tend to intensify as the household debt-to-GDP ratio exceeds 60%. On the other hand, Pescatori et al. (2014) argue there is no simple debt ratio threshold above which medium-term growth prospects are severely undermined. Identifying a debt threshold has the advantage of giving policymakers a single number to benchmark against. However, it effectively abstracts from a comprehensive assessment of structural risks and their relationship with cyclical economic developments. Structural risks are not likely to develop in isolation but can create clusters of related structural risks that can jointly amplify an adverse shock. In our paper, we focus on an extensive dataset covering all sorts of structural risks.

### **2.3 Interaction of Structural and Cyclical Risks**

Structural and cyclical risks are not independent, and the nature of their interaction may change over the course of the financial cycle. This interplay can take several forms, the most important of which points to the importance of structural risks for the accumulation and subsequent materialization of cyclical risk. Shin (2010) states that increased systemic risk from interconnectedness of banks is a corollary of excessive asset growth. On the other hand, Stremmel and Zsámboki (2015) show that some structural characteristics of the banking sector (structural risks) have an impact on the amplitude of the financial cycle. We show this relationship in a stylized setting in Figure 1, where a higher level of structural risks links to more pronounced materialization of the cyclical part of systemic risk.

Empirical studies on the interplay between cyclical and structural risks are scarce and usually consider no more than one structural feature at a time, leaving the rest of the financial sector or real economy characteristics constant. To our knowledge, there are only two other papers on this topic. Stremmel and Zsámboki (2015) study the empirical relationship between cyclical features of the banking sector and a set of structural characteristics. They find that the concentration of the banking sector, the share of foreign banks, the size and stability of financial institutions, the share of foreign currency loans and financial interlinkages contribute to the amplitude of the financial cycle and hence to the variability of financial cycles. Ari et al. (2020) identify key risk factors that increase the severity of the rapid growth of non-performing loans (NPL) during banking crises. Those factors include high credit growth, high government debt and high corporate debt with short maturity.

**Figure 1: Stylized Interplay Between the Cyclical and the Structural Part of Systemic Risk**



*Note:* Own processing.

We use the analyses of Stremmel and Zsámboki (2015) and Ari et al. (2020) as a starting point and modify them in several ways. First of all, unlike Stremmel and Zsámboki (2015), we focus on the materialization of cyclical risk, i.e. on the descending phase of the financial cycle, similarly to Ari et al. (2020). We use a broader set of structural risks than both of the aforementioned papers. Finally, we substantially extend the analysis of the relationship between cyclical and structural risks. We consider an event-study approach similarly to both papers, but we further propose a simple regression approach using panel data, which allows us to control for a much higher number of confounders. In this approach, we use several alternatives to capture the downward phase of the cycle and a broad set of structural risks.

### 3. Data on Cyclical and Structural Risks

We use quarterly country-level data from 30 advanced countries to examine the relationship between cyclical risk and structural features of the financial system and the real economy. Our data span a maximum period of 2006Q1–2019Q4. The sample period is determined primarily by the focus of the study on cyclical risk materialization during and after the GFC. We deliberately restrict our sample to end in 2019Q4 to avoid the Covid crisis, which is beyond the scope of this study.

We rely on three types of data. First, we require a measure of cyclical risk. For this purpose, we collect data on the stock of private credit and house prices and use them to craft a composite financial cycle measure. We complement our naive “financial cycle index” with other widely used composite indexes taken from Lang et al. (2019) and Aldasoro et al. (2020). We also consider a subset of cyclical risk – credit risk as proxied by the NPL ratio. Second, we construct an extensive dataset covering all sorts of structural risks. Third, we collect several macroeconomic controls from numerous data sources.

### 3.1 How To Measure Cyclical Risk

Since the GFC, the literature has focused on defining and measuring risks stemming from the course of the financial cycle. Although some studies tend to favour a parsimonious description of the financial cycle defined in terms of only one variable (Schularick and Taylor, 2012; Aikman et al., 2015),<sup>2</sup> various composite indicators of the financial cycle have grown in popularity (Drehmann et al., 2012; Hollo et al., 2012). The latter stream of literature builds on the premise that relevant features of the financial cycle are reflected in multiple indicators, and considering them all together allows for more precise measurement. Hence, studies began to combine information from multiple time series into a single representative measure of the financial cycle.

A composite financial cycle indicator should be more successful than a single measure in reducing the uncertainty arising from the unclear definition of the financial cycle. In this respect, we follow Drehmann et al. (2012) and Borio (2014) in combining the information contained in credit aggregates and property prices into a single measure of the financial cycle. As noted by Borio (2014), credit and property prices represent analytically the smallest set needed to replicate the mutually reinforcing interaction between financing constraints (as represented by the credit-to-GDP ratio) and perceptions of asset prices (as represented by property prices).<sup>3</sup>

Although the literature has provided valuable insights into the measurement of the financial cycle, it has fallen short of developing a widely accepted construction technique for deriving a financial cycle indicator. In what follows, we consider three approaches to deriving a financial cycle measure.

First, we use a frequency-based filter to extract the cyclical component from the three time series under consideration: the credit-to-GDP ratio, the house price index and private sector credit growth.<sup>4</sup> Specifically, we use the band-pass filter developed in Christiano and Fitzgerald (2003), although the choice of filtration method does not seem to drive the estimation output.<sup>5</sup> We then use principal component analysis (PCA) to extract the first common component of the series under consideration. PCA has been used extensively in the literature for developing various financial stress measures (Illing and Liu, 2006; Hakkio et al., 2009; Cevik et al., 2013). The variables are normalized prior to entering the PCA. We estimate the common factor for each of the 30 advanced countries that form our sample.<sup>6</sup>

Figure 2 offers a cross-country perspective of the estimated common factor and its evolution around systemic events. The mean of the indicator starts to increase four years before the outbreak of the GFC. If we set the value of the indicator in “normal times” to zero, the graph clearly shows a build-up of imbalances before the crisis, followed by a sharp decline as the crisis starts and the

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<sup>2</sup> In such studies, the financial cycle is expected to be driven predominantly by credit and to some extent by asset prices.

<sup>3</sup> Clearly, these two variables represent a compromise with regard to the ideal set of information for measuring the financial cycle. Our choice of variables was primarily data-driven. For example, it would be preferable to include key systemic risk propagation mechanisms such as actual leverage and maturity mismatch, but long country-level time series are too scarce in these cases for our international sample.

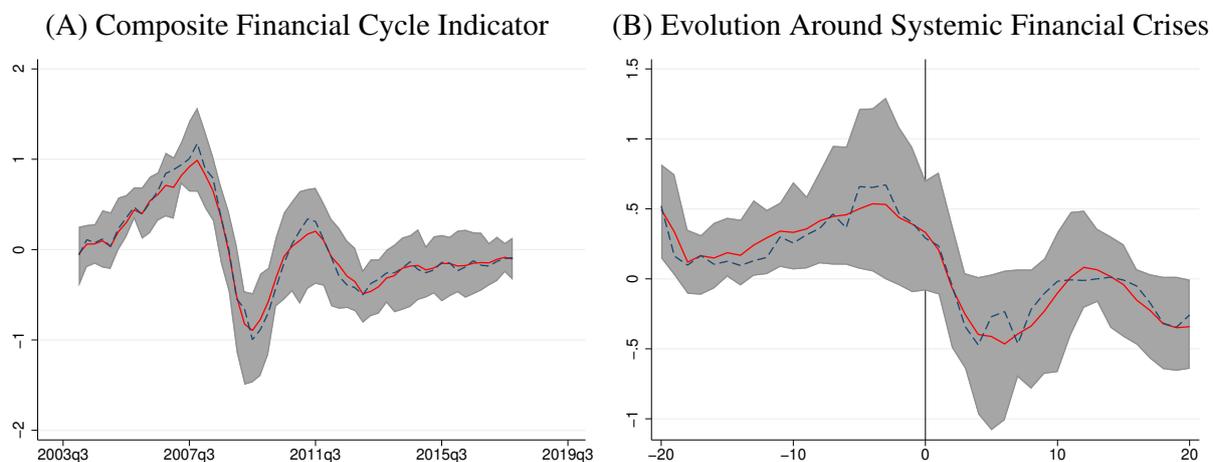
<sup>4</sup> We follow Stremmel and Zsámboki (2015) in considering the duration of a financial cycle to span from 32 to 120 quarters (or 8 to 30 years).

<sup>5</sup> A two-sided Hodrick-Prescott filter with lambda equal to 400,000 delivers roughly the same estimate for the 2003Q1–2017Q4 period.

<sup>6</sup> The cumulative percentage of the variance explained by the first principal factor ranges from 48 to 86 in the sample of countries. By using two measures of credit and only one measure of asset (house) prices, the factor loads more on the credit dynamics. The focus on credit dynamics is justified by the well documented fact that credit booms typically precede crises (Jordà et al., 2011; Schularick and Taylor, 2012).

cyclical risk materializes. Interestingly, the indicator peaks four quarters before the beginning of the GFC. This suggests that the indicator, as naive as it is, might possess some early warning properties, even though this is not its purpose.

**Figure 2: Cross-country Distribution of the Estimated Financial Cycle Index**



**Note:** Panel A: The shaded region marks the area between the first and third quartile of the cross-country distribution. The solid red line denotes the mean and the dashed blue line the median. The sample size is 30 countries. Panel B: the x-axis depicts the number of quarters before/after systemic financial crises.  $t = 0$  marks the beginning of a crisis any time during the 2004Q1–2019Q4 time span according to the ECB/ESRB crises database described in Lo Duca et al. (2017).

**Source:** Own computation based on various data sources.

Second, we consider the composite financial cycle index developed in Drehmann et al. (2012), who apply the Christiano and Fitzgerald (2003) filter to three series: (i) the credit-to-GDP ratio, (ii) annual growth of residential property prices and (iii) annual growth of credit to the non-financial private sector. Similarly to our first method, all the time series are normalized to ensure comparability. The filter is applied in the medium-term frequency range (32 to 120 quarters). This indicator requires long time series to be estimated, so it is available for a smaller sample of 24 countries. The cross-country distribution of the resulting indicator is shown in Figure A2 in Appendix A.

Third, we use the domestic cyclical systemic risk indicator introduced in Lang et al. (2019). This indicator captures risks stemming from the domestic credit and real estate markets, asset prices and external imbalances and is defined as a weighted average of several normalized sub-indicators in the spirit of Hollo et al. (2012). The indicator is available only for EU countries, meaning it covers a total of 15 countries in our sample. It is shown in Figure A2 in Appendix A.

As a sensitivity check, we also consider a subset of cyclical risk – credit risk, which we proxy by the non-performing loans to total loans ratio. The NPL ratio has been widely used in the literature to capture the evolution of credit risk (Babihuga, 2007; Festić et al., 2011; Fungáčová and Poghosyan, 2011; Ari et al., 2020).

### 3.2 Forming the Dataset on Structural Risks

We use two approaches (turning point analysis and panel regression) to clarify the relationship between cyclical and structural risks. Both of these approaches require a comprehensive dataset on various structural risks. We construct an extensive dataset that contains 16 types of structural

risks based on our categorization (see Table 1). The data covers the period 2006Q1–2019Q4 and is obtained from several statistical databases and previous empirical studies. For the vast majority of the structural risks covered, we have more than 1,000 observations available to create a rich database that ensures sufficient robustness of the results. This data is described and defined in detail in Table A1 in Appendix A. Basic descriptive statistics for the variables are then shown in Table A2 in Appendix A.<sup>7</sup> The relations between the structural risk variables are described in a correlation matrix (Figure A3). The correlation matrix illustrates potential clusters of structural risks associated with low resilience (capital ratio and profitability), high vulnerability (indebtedness and debt service) and the importance of the banking sector to the economy (assets to GDP, bank-based financial system and financial openness).

## 4. Turning Point Analysis

Using a simple event-study framework, we take a first look at the relationship between cyclical and structural risks using the set of indicators defined above. Being aware of the challenges inherent to exploring the financial cycle's recurrent nature, we adopt a phase-centric approach originally proposed for analysis of the business cycle (Burns and Mitchell, 1946). Using this approach, we define units of cyclical time as a sequence of phase turning points. In our application, we focus on the recessionary phase of the financial cycle (from peak to trough), which constitutes one unit of cyclical time (regardless of the elapsed calendar time). We then summarize the changes in both cyclical and structural risks in each of the phase-based time units and assess the co-movements.

We focus on the period surrounding and following the outbreak of the GFC. This period has several favourable properties. First, the GFC itself was a textbook example of a crisis created by endogenously accumulating imbalances in the financial sector (similarly to the eurozone debt crisis that followed). As pointed out by Claessens et al. (2011) and Filardo et al. (2018), not all financial cycles are the same (although they do share some commonalities), so focusing on a narrower time span might yield more precise estimates. Second, we benefit from the improved data coverage in the IMF FSI database following the related 2006 initiative and the latest 2019 update.

### 4.1 Methodology

Our specific methodology for identifying turning points is based on Harding and Pagan (2002), which is an extension of the BB algorithm developed by Bry and Boschan (1971). The algorithm is meant to identify turning points in the logarithm of a series.<sup>8</sup> Hence, we focus on changes in the levels of the variables. This is of utmost importance given the focus of our paper on both the cyclical and structural features of systemic risk. Using the algorithm, we search for local maxima and minima of our handcrafted financial cycle indicator, while imposing certain rules. Specifically, we require the duration of the materialization phase to be at least four quarters ( $d = 4$ ). The break between individual cycles is set to be at least four consecutive quarters of growth.  $d$  is set in a way that allows us to encompass the materialization of cyclical risk during a shallow recession or an economic slowdown, when loan defaults are not on a scale that leads to systemic losses and the risks diminish mainly through loan repayment and the application of more stringent credit standards to refinancing and new lending.

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<sup>7</sup> Note that cyclical risks are also listed at the bottom of these tables.

<sup>8</sup> Applications of the BB algorithm include, but are not limited to, business cycle research (King and Plosser, 1994; Watson, 1994) and research concerning the cyclical movements of equity and housing prices (Pagan and Sossounov, 2003; Bracke, 2013).

The peaks (local maxima) and troughs (local minima), i.e. our turning points, are defined using the following rules.

A cyclical risk peak as depicted by the cyclical risk indicator ( $f$ ) occurs at time  $t$  if

$$\{[(f_t - f_{t-d}) > 0, (f_t - f_{t-1}) > 0] \wedge [(f_{t+d} - f_t) < 0, (f_{t+1} - f_t) < 0]\}, \text{ where } d \geq 4. \quad (1)$$

A cyclical risk trough occurs at time  $t$  if

$$\{[(f_t - f_{t-d}) < 0, (f_t - f_{t-1}) < 0] \wedge [(f_{t+d} - f_t) > 0, (f_{t+1} - f_t) > 0]\}, \text{ where } d \geq 4. \quad (2)$$

Having specified the turning points, we proceed by computing the amplitude of cyclical risk materialization for each country in our sample. The amplitude measures the change in  $f_t$  from a local maximum ( $f_{max}$ ) to the nearest local minimum ( $f_{min}$ ) multiplied by the duration ( $d$ ) to account for the intensity and length of the materialization of cyclical risk:<sup>9</sup>

$$A_m = (f_{max} - f_{min}) \times d. \quad (3)$$

We identify 69 phases of cyclical risk materialization in our sample of countries over the period 2006Q1–2019Q4. A quick overview is available in Table 2. A majority of the countries in the sample experienced at least two episodes of cyclical risk materialization, lasting from six to nine quarters on average. The first amplitude identified was the most intense. This is not surprising, as for most countries it is linked to the period surrounding the GFC. The second amplitude captures the period of the eurozone sovereign debt crisis. The third amplitude is mostly country specific, without a clear common denominator. According to the mean of the amplitude, the most severe materialization phase was identified in the cases of Greece, the United States, Portugal and Italy (Table A3 in Appendix A).

**Table 2: Amplitudes of Cyclical Risk Materialization: Summary Statistics**

Amplitude ( $A_m$ )	Mean	Median	Min	Max	Standard deviation	No. of countries	Average duration
1	14.21	13.36	1.32	42.75	9.15	30	8
2	11.25	9.02	1.64	60.37	11.63	29	9
3	6.51	5.55	2.37	13.24	3.22	10	6

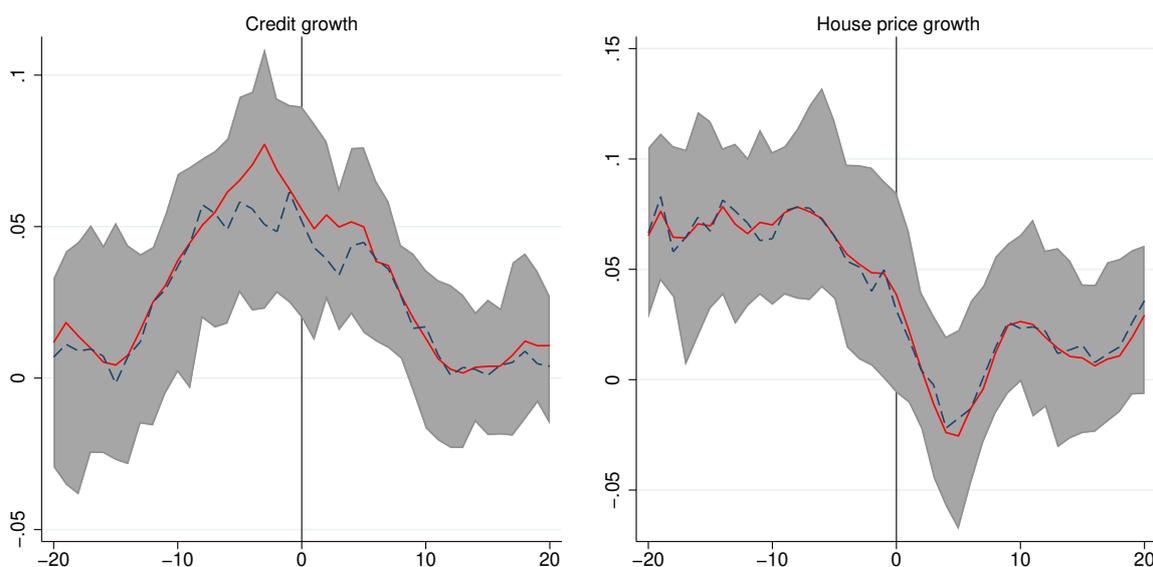
**Note:** Table A3 in Appendix A shows the estimated amplitude and duration values for individual countries.

To demonstrate the validity of our identification approach, we plot credit and house prices during a five-year window around the starting date ( $t=0$ ) of the first amplitude identified (Figure 3). This point reflects the peak of the cycle and the starting point of cyclical risk materialization. The graphs show a gradually increasing rate of credit growth and considerable growth of house prices in the period preceding the starting date. They also nicely depict the fall in the growth rates of both credit and house prices right after the peak point. Note that house price growth starts to slow approximately six quarters before the identified peak point. This is not surprising given previous

<sup>9</sup> In fact, the length of the materialization of cyclical risk is likely to be a very important dimension for countries with a high and persistent level of structural risks.

research showing that property prices peak well ahead of crises (Drehmann and Juselius, 2014). In a similar fashion, we plot real GDP growth and the unemployment rate around the start of the cyclical risk materialization phase (Figure A4). This reveals that in our sample of countries, real GDP growth dropped by approximately 6 percentage points (pp) around the start of the first amplitude, bottoming around six to eight quarters past the peak point. In addition, the unemployment rate increased by around 2 pp on average in the two years following the start of a crisis.

**Figure 3: Cross-country Distribution of Credit and House Price Growth Around the Start of the Cyclical Risk Materialization Phase**



**Note:** The shaded region marks the area between the first and third quantile of the cross-country distribution. The solid red line denotes the mean and the dashed blue line the median.

**Source:** Own computation.

## 4.2 Correlation Analysis

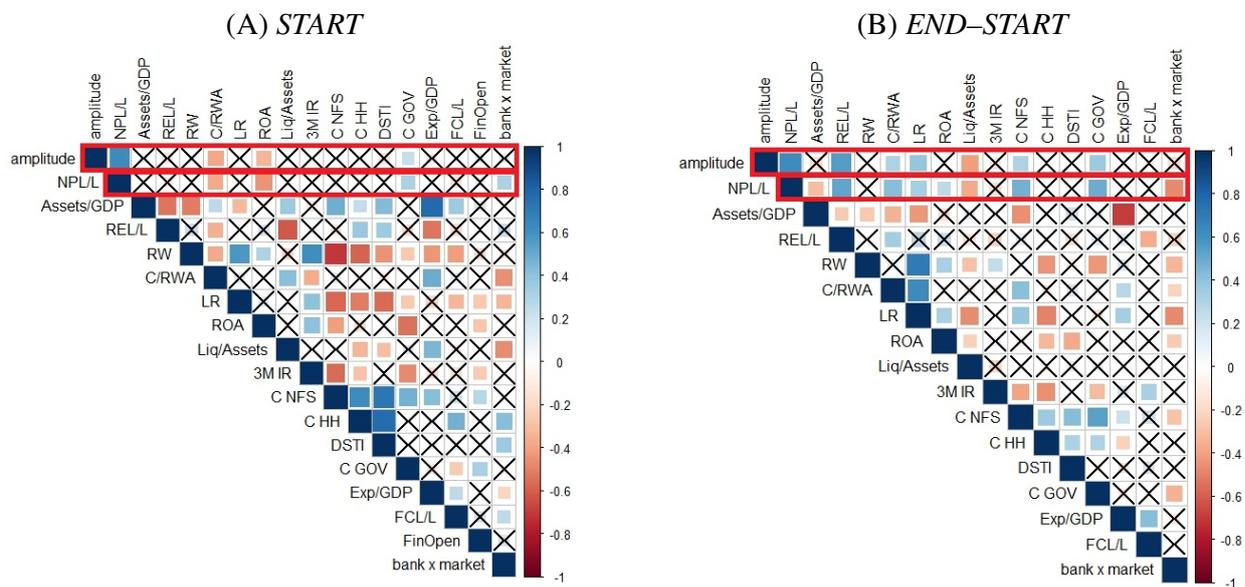
In what follows, we match the identified amplitudes of cyclical risk materialization with the levels of individual structural risks to shed some light on their mutually reinforcing relationship. First, we consider the level of the structural indicator at the start of the materialization phase.<sup>10</sup> By doing so, we are able to assess (albeit indirectly) whether the initial level of structural risks could have determined the extent to which cyclical risk materialized. We mark this approach with the prefix *START* in the following analysis. Second, we calculate the difference between the values of the structural indicator at the start and the end of the cyclical risk materialization phase.<sup>11</sup> This approach allows us to check how structural risks evolved over the whole course of cyclical risk materialization. This approach is marked as *END–START*. Using the two approaches, we obtain a comprehensive story of the interaction of structural and cyclical risks during financial cycle contractions.

<sup>10</sup> For instance, if  $f_t$  marks the start of the first financial cycle materialization phase at 2008Q3 and the end at 2010Q4, we pair the  $A_m$  value [(2008Q3 value – 2010Q4 value) times 10] with the level of the structural risk indicator at 2008Q3.

<sup>11</sup> Under this approach, we pair the cyclical risk materialization amplitude ( $A_m$ ) with the difference between the level of the structural risk indicator at the end and the start date of the cyclical risk materialization phase.

Next, we run a correlation analysis using the *START* and *END-START* approaches. In the correlation matrices, our main variable of interest is the calculated cyclical risk materialization amplitude and its correlation with various structural risks. The correlation matrices are shown in Figure 4. The left-hand panel A is the correlation outcome of the amplitude ( $A_m$ ) and the structural risk values at the start of the cyclical risk materialization phase. The right-hand panel B shows the correlations of  $A_m$  and the difference in the structural risk values between the end and the start of the cyclical risk materialization phase. We check the consistency of the correlations by considering the change in the NPL ratio (credit risk materialization) during the periods that were identified by the turning point analysis. We expect cyclical risk materialization ( $A_m$ ) and credit risk materialization ( $NPL/L$ ) to be highly correlated, as credit risk is a subset of cyclical risk.

**Figure 4: Correlation Matrices for Financial Cycle Amplitude and Individual Structural Risks**



**Note:** Crossed fields denote a statistically insignificant correlation coefficient at the 5% level as evidenced by t-statistics. The mnemonics are as follows: amplitude = cyclical risk materialization amplitude, NPL/L = non-performing loans to total loans, Assets/GDP = total banking sector assets to GDP, REL/L = residential real estate loans to total loans, RW = risk weights, C/RWA = regulatory capital to risk-weighted assets, LR = leverage ratio, ROA = return on assets, Liq/Assets = liquid assets to total assets, 3M IR = three-month interbank rate, C NFS = credit to non-financial sector to GDP, C HH = credit to households to GDP, DSTI = debt-service to total income, C GOV = credit to government to GDP, Exp/GDP = exports to GDP, FCL/L = foreign currency loans to total loans, FinOpen = financial openness index, bank x market = bank to market ratio.

**Source:** Own computation.

The correlation pairs for the *START* specification point to several possibly stylized facts. They show that countries with a low initial (pre-crisis) level of banking sector resilience (a low capital ratio and low profitability) experienced greater and longer materialization of cyclical and credit risk. Thakor (2014) documents that lower bank capital leads to higher systemic risk and a higher probability of a government-funded bailout that may elevate government debt and trigger a sovereign debt crisis. We find that the starting level of government debt is also positively correlated with cyclical and credit risk materialization. A high level of government debt has been found to be detrimental for the aftermath of crises (Cecchetti et al., 2011; Romer and Romer, 2018).<sup>12</sup> The correlation analysis provides solid ground for additional analysis using panel data regressions, which allow us

<sup>12</sup> Similar evidence can be found in the case of private debt (Mian et al., 2017).

to determine whether the simple bivariate correlations can survive increasingly demanding statistical tests.

Considering the *END–START* specification reveals additional interesting patterns in the data. Not surprisingly, we find that more severe cyclical risk materialization is associated with larger materialization of credit risk (i.e. an increase in the NPL ratio). Furthermore, we find that countries which experienced greater cyclical or credit risk materialization also recorded a bigger increase in the capital ratio. This coincides with the conclusion reached by the 2018 report of the Committee on the Global Financial System (CGFS, 2018) that, following the GFC, banks enhanced their resilience to future risks by substantially building up capital buffers. At the same time, countries with deeper financial cycle contractions experienced a more severe deterioration in the liquidity position of the banking sector. Further, higher cyclical and credit risk materialization coincides with faster growth of private and public debt. The recession that went hand in hand with the last period of financial distress led to a decrease in sales, which resulted in a greater need of non-financial corporations to turn to debt financing. Longer and deeper financial cycle contractions also necessitated higher government support, reflected in an increased level of public debt. In a related study, Ari et al. (2020) find that countries that resolve their NPLs rapidly tend to have less depressed output and a faster economic recovery following a banking crisis. This last piece of evidence echoes the literature discussing the cleansing effect of recessions (Schumpeter, 1939, 1942) and the “unfinished recession” phenomenon. The latter – coined in Drehmann et al. (2012) – broadly describes an “overreaction” by policymakers to unfavourable short-term developments, eventually leading to even bigger market frictions in the future.

We detect other interesting patterns outside our focal point that warrant comment. For the *START* specification, various correlations with the interbank rate, which serves as our monetary policy proxy, suggest that countries with an initially low interest rate (i.e. a low value at the start of each cyclical risk materialization period) also had a high level of private and government sector indebtedness. At the same time, a low interest rate was significantly correlated with a low leverage ratio, a low return on equity and a worse liquidity position, which signals lower resilience of the financial sector to adverse market shocks. Considering the *END–START* specification further shows that the post-crisis easing of monetary policy was correlated with substantial increases in both private and public sector indebtedness. This also links to the “overreaction” of policymakers to short-term disturbances mentioned earlier.

On the one hand, monetary policy easing increases the resilience of the financial system in the short term via better access to funding and improved borrower creditworthiness, supporting the creation of bank capital and reducing bankruptcies (Gertler et al., 2013; Kiyotaki and Moore, 2019). This is also apparent from our correlation matrix, where lower interest rates are correlated with lower risk weights in the banking sector. On the other hand, a prolonged period of low interest rates can increase financial vulnerabilities (Adrian and Liang, 2018), depressing the profitability of financial institutions (Altavilla et al., 2018) and consequently reducing their capitalization. Furthermore, Borio and Zhu (2012) and Bonfim and Soares (2018) provide evidence for the existence of a risk-taking channel of monetary policy. This is particularly the case when the low interest rate environment lasts for an extended period of time, referred to as “too low for too long” (ESRB, 2021). However, low interest rates, as a structural risk, also affect valuations, incomes and cash flows, which in turn can modify how banks measure risk (Gambacorta, 2009).<sup>13</sup>

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<sup>13</sup> For a comprehensive summary and discussion of the benefits and costs of a low interest rate period, see also Malovana et al. (2020).

As a robustness check, we consider the identified financial cycle amplitudes separately. Specifically, we focus the correlation analysis on the first and the second amplitudes identified, which for most countries link to the GFC and the eurozone debt crisis respectively. Given the narrow gap between the occurrence of these two crises, we only consider the START specification. The correlation matrices are given in Figure A5 in Appendix A. The extent of both cyclical and credit risk materialization related to the occurrence of the GFC was negatively correlated with interest rates and banking sector resilience (ROA and regulatory capital ratio). The amplitude related to the eurozone debt crisis further highlights the important role of government debt, which is not surprising given the source of the crisis.

## 5. Panel Regression Approach

In the panel regression approach, we use an unbalanced cross-country time series dataset comprising 30 OECD countries over the period 2008Q3–2019Q4. The following equation describes our empirical approach:

$$Cyclical_{it}^{mat} = \beta Structural'_{it-4} + \gamma \mathbf{X}'_{it-4} + \mu_i + \tau_t + \varepsilon_{it}, \quad (4)$$

where the dependent variable  $Cyclical_{it}^{mat}$  represents the materialization phase of a given cyclical risk indicator,  $Structural'_{it-4}$  is a row vector of structural risks,  $\mathbf{X}'_{it-4}$  is a row vector of macro controls,  $\mu_i$  captures unobserved country-specific effects,  $\tau_t$  captures time-specific effects and  $\varepsilon_{it}$  is the error term. The main parameter of interest is  $\beta$ , which captures the elasticity between cyclical risk materialization and structural risks.

Our panel-data units (countries) probably differ systematically from one another in unobserved ways that affect the outcome of interest. We therefore use unit fixed effects, since they eliminate all between-unit variation, producing an estimate of a variable's average effect within units over time (see, for example, Allison, 2009; Wooldridge, 2010). We also use time fixed effects, since the variables of interest exhibit substantial variability over time. We expect that our dataset contains period-to-period shocks to the outcome variables that apply to all units of the analysis equally. By employing time fixed effects, we deal with time-variant unobservables that are not unit specific. Still, our model shows the individual time trends of our variables, but only using the variations that are not common to all units.

Generally, we aim to adjust our model for unobserved, unit-specific and time-invariant confounders when estimating causal effects from our data. Through this process, we aim to reduce selection bias in the estimation of causal effects by eliminating large portions of variation thought to contain confounding factors.

When considering left-hand side variables, we are driven by the following economic intuition. In general, the nature of any decline in cyclical risks can be of two forms: (i) a shallow recession or an economic slowdown, when loan defaults are not on a scale that leads to systemic losses and the risks diminish mainly through loan repayment and the application of more stringent credit standards to refinancing and new lending, and (ii) materialization during a severe recession (or even a financial crisis), when loan defaults caused by the highly adverse economic developments are on a scale that leads to systemic losses. These forms of decline in cyclical risks can overlap and their relative significance will differ depending on the intensity and length of the recessionary phase of the cycle. This boils down to several indicators (considered one-by-one) that should be successful in capturing both a shallow recession and severe materialization of cyclical risk: (i) various composite indicators

of cyclical systemic risk, and (ii) the NPL ratio, which proxies the credit losses of the banking sector and hence represents a subset of cyclical risk – credit risk.

Given our focus on the cyclical and credit risk materialization phase ( $Cyclical_{it}^{mat}$ ), we select only those periods for which the first difference of the given cyclical risk indicator is below zero, such as  $Cyclical_{it} - Cyclical_{it-1} < 0$ . Analogously, we focus only on periods where the first difference of the NPL ratio is above zero ( $NPL_{it} - NPL_{it-1} > 0$ ). These periods are then matched with the corresponding values of structural risks and other right-hand side controls.

Our models are estimated using the ordinary least squares estimator with heteroscedasticity-corrected standard errors. We also perform robustness checks with respect to the estimation method, where we use the Driscoll and Kraay (1998) estimator with Driscoll-Kraay standard errors, which are well calibrated when cross-sectional dependence is present (Hoechle, 2007). For country-specific dependence, we include country dummies, but we also try clustering the standard errors by country. These estimates are available from the authors upon request.

A note on the endogeneity issue. Examining the role of structural risks in explaining the extent to which credit or cyclical risks materialize is a complicated task that needs to be handled with care. The difficulties stem from the risk of not sufficiently addressing multiple endogeneity issues, in our case *reverse causality bias* and *omitted-variable bias*. As regards reverse causality, a possible concern could be that during a financial cycle downturn, structural risks tend to increase as a result of, for example, government support of the economy. If left uncorrected, this bias could somewhat inflate our estimated parameters, making them the upper bound of the true relationship. To cater for this possibility, we lag the structural risk indicators and other control variables by one year (four quarters). We also try to split our sample into two groups based on the level of structural risks. We formally examine the causal relationship between cyclical risk materialization and structural risks by employing panel Granger causality tests. The test results are presented in Table B1 in Appendix B. The tests reject the null hypothesis that structural risks do not Granger-cause cyclical risk materialization for all of the panel units. For a majority of the structural risks, the causality runs in only one direction. The use of relatively high-frequency quarterly data should also be helpful in mitigating the endogeneity concerns stemming from reverse causality. Omitted-variable bias is of less concern, as we consider multiple right-hand side controls and country-fixed effects that account for changes within groups across time.

## 5.1 Do Structural Risks Explain Periods of Cyclical Risk Materialization?

In this section, we describe the main findings stemming from our exploration of the relationship between structural risks and cyclical risk materialization. We consider the impact of structural risks on various composite cyclical risk indicators and banking sector losses (proxied by the NPL ratio).

We consider different model specifications based on the selection of structural risks in the vector  $Structural'_{it-4}$ . We start by regressing  $Cyclical_{it}^{mat}$  on those structural risks which were identified as significant in the correlation analysis in the previous section. We deliberately omit some of the previously considered structural risks due to endogeneity issues (the asset-to-GDP ratio), an insufficient number of observations (the ratio of foreign currency loans to total loans) or a lack of any time variation (financial openness). Our final specifications are also respectful of the presence of multicollinearity between pairs (groups) of structural risks. For instance, we do not consider the leverage ratio, bank risk weights and the capital ratio in the same specification. We formally check for multicollinearity in our regressions by calculating the variance inflation factor and assessing its value for individual variables.

First, we regress cyclical risk materialization (as seen through the quarter-on-quarter decreases in the different composite cyclical risk indicators) on individual structural risks and a set of macroeconomic controls. The estimates, given in Table 3, show that the extent of cyclical risk materialization is negatively correlated with private and public sector indebtedness, real estate exposure, the bank-to-market ratio and bank risk weights, and positively correlated with financial sector resilience indicators (the regulatory capital ratio and the leverage ratio) and the interest rate. These empirical facts appear to correctly describe the structural sources of the financial imbalances during the period under review. The estimated parameters are robust to changes in the empirical specification and different cyclical risk indicators. We proceed with a more focused analysis of the relationship between structural risks and credit risk materialization, which has a direct impact on the stability of a country's financial sector.

**Table 3: Structural Risks and Cyclical Risk Materialization**

Dep. var.:	FCI(own)		FCI(BIS)		FCI(ECB)	
	(1)	(2)	(3)	(4)	(5)	(6)
Private debt	-0.031** (0.012)	-0.036** (0.018)	-0.025** (0.012)	-0.008 (0.037)	-0.038** (0.016)	-0.035*** (0.010)
Government debt	-0.073* (0.040)	-0.103** (0.052)	-0.059** (0.025)	-0.079** (0.031)	-0.082** (0.032)	-0.107** (0.041)
Real estate exposure	-0.118* (0.062)	-0.260** (0.128)	-0.247** (0.109)	-0.385*** (0.126)	-0.161* (0.087)	-0.320*** (0.101)
Liquidity ratio	-0.010 (0.043)	0.003 (0.058)	-0.019 (0.043)	-0.012 (0.057)	-0.032 (0.034)	0.024 (0.046)
Bank-to-market ratio	-0.517*** (0.094)	-0.569*** (0.123)	-0.316*** (0.095)	-0.445*** (0.121)	-0.271*** (0.076)	-0.322*** (0.098)
Reg. capital ratio	0.359** (0.180)		0.457** (0.182)		0.281* (0.145)	
Leverage ratio		2.967*** (0.501)		2.988*** (0.493)		2.379*** (0.397)
Risk weights		-0.264*** (0.101)		-0.335*** (0.099)		-0.230*** (0.080)
Interest rate	0.556 (0.393)	1.160** (0.468)	1.019** (0.398)	1.531*** (0.461)	0.539* (0.317)	0.774** (0.371)
Trade openness	-0.067* (0.041)	-0.047 (0.050)	-0.019 (0.041)	0.004 (0.049)	-0.141*** (0.033)	-0.108*** (0.040)
<i>N</i>	628	476	688	519	375	268
adj. <i>R</i> <sup>2</sup>	0.239	0.267	0.285	0.342	0.203	0.244
F-test	7.534	7.434	9.286	10.215	6.312	6.702
	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
Macro controls	Yes	Yes	Yes	Yes	Yes	Yes
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

**Note:** The dependent variables are the period-to-period decreases of the individual cyclical risk indicators over the period 2008Q3–2019Q4. FCI(own) denotes the handcrafted composite financial cycle indicator that was estimated for the purpose of capturing the evolution of cyclical risk in our sample countries. FCI(BIS) is the financial cycle indicator introduced in Drehmann et al. (2012). FCI(ECB) represents the domestic financial cycle indicator described in Lang et al. (2019). Robust standard errors in parenthesis. The constant was estimated but is not reported. Macro controls include real GDP growth and the rate of inflation. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

## 5.2 Narrowing the Concept of Cyclical Risk Materialization

While the use of composite cyclical risk indicators allows us to encompass different sources of risk, it complicates any attempt to quantify the magnitude of the relationship between cyclical risk materialization and structural risks. To mitigate this issue, we next consider a subset of cyclical risk – credit risk, as proxied by the observed increases of the NPL ratio during the period under review.

Analogously to our previous empirical exercise, we regress the degree of credit risk materialization on the vector of structural risks and other controls. We find the degree of credit risk materialization to be negatively associated with past values (four quarters) of the indebtedness of sectors of the real

economy, the concentration of real estate exposures (as measured by the share of real estate loans in total loans) and the structure of the financial sector (bank-based vs. market-based). The variables enter as significant across all the regression specifications shown in Table 4. The related parameters can be interpreted as the mean elasticity between credit risk materialization and past realizations of structural risks in the sample of countries. As the estimated effect shows, 10 pp higher private and public sector indebtedness is associated with a 0.8 pp and 1.1 pp higher NPL ratio respectively. We have an average NPL ratio of 4.3% in our sample, so the estimated effect is economically significant. Analogously, 10 pp higher concentration of real estate exposures would be associated (on average) with a 1.6 pp higher NPL ratio. Another finding worth noting is that countries with a larger role of the banking sector in financial intermediation experienced higher credit risk materialization on average. Early literature (Levine, 2002) suggests that the overall performance of the economy (in terms of GDP growth) depends not on the financial structure (bank based vs. market based), but rather on the quality of the financial services produced by the entire financial system. On the other hand, recent literature (Langfield and Pagano, 2016; Bats and Houben, 2020) shows that bank-based financial structures are associated with higher systemic risk than market-based ones. In more bank-based financial structures, bank financing is found to increase systemic risk and market financing to reduce it. This seems to be in line with our results.<sup>14</sup> We also find that countries with higher trade openness experienced more pronounced credit risk materialization.

Banking sector resilience is found to be negatively associated with credit risk materialization as seen through growth in the NPL ratio. A higher regulatory capital ratio, a higher liquidity ratio and a higher leverage ratio (all lagged by four periods) are linked with a smaller increase of the NPL ratio. The estimates retain significance across the different specifications. When we consider the relationship between the reported bank risk weights and NPL ratios, the parameter estimates come in positive, in line with the previous set of results. A higher aggregate risk weight indicates a riskier portfolio, as evidenced by the results – 10 pp higher risk weights are associated with a 1.9 pp higher NPL ratio. Lower interest rates appear to be associated with a higher NPL ratio as well. A 1 pp drop in the level of interest rates relates to a 0.3 pp increase in the NPL ratio.

Overall, we identify a potentially non-negligible role for structural risks in explaining the degree of credit risk materialization. However, the estimated elasticities represent the *average* effect and say nothing about the relationship between the *level* of structural risks and cyclical risk materialization. To address this issue, we next consider multiple sample splits to capture the level impact of structural risks.

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<sup>14</sup> The post-GFC literature warns about certain aspects of market-based financing (Adrian and Shin, 2010) that are generally perceived as risky, such as the non-bank financial intermediation (Cizel et al., 2019; Hodula et al., 2020; Irani et al., 2021).

**Table 4: Structural Risks and Credit Risk Materialization**

Dep. var.: NPL ratio	(1)	(2)	(3)	(4)
Private debt	0.080*** (0.018)	0.081*** (0.020)		
Government debt	0.105*** (0.021)	0.153*** (0.028)	0.166*** (0.028)	0.153*** (0.028)
Household debt			0.172*** (0.041)	
Non-financial sector debt				0.061** (0.027)
Real estate exposure	0.145** (0.058)	0.166** (0.068)	0.119* (0.067)	0.152** (0.069)
Liquidity ratio	-0.084*** (0.025)	-0.082*** (0.021)	-0.082*** (0.021)	-0.091*** (0.021)
Bank-to-market ratio	0.130** (0.051)	0.116* (0.066)	0.118* (0.065)	0.184** (0.069)
Reg. capital ratio	-0.193** (0.085)			
Leverage ratio		-1.104*** (0.266)	-1.200*** (0.271)	-1.058*** (0.264)
Risk weights		0.190*** (0.054)	0.185*** (0.054)	0.189*** (0.054)
Interest rate	-0.362* (0.214)	-0.229* (0.150)	-0.345* (0.154)	-0.117 (0.151)
Trade openness	0.083*** (0.024)	0.075*** (0.027)	0.079*** (0.025)	0.068** (0.028)
Macro controls	Yes	Yes	Yes	Yes
Country fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
<i>N</i>	800	622	622	622
adj. <i>R</i> <sup>2</sup>	0.514	0.516	0.517	0.508
F-test	22.651	19.630	19.731	19.039
	0.000***	0.000***	0.000***	0.000***

**Note:** The dependent variable is the ratio of non-performing loans to total loans expressed as the period-to-period increases over the period 2008Q3–2019Q4. Robust standard errors in parenthesis. The constant was estimated but is not reported. Macro controls include real GDP growth and the rate of inflation. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

### 5.3 Considering the Level of Structural Risks

We divide our sample of 30 OECD countries into two sub-samples according to the pre-crisis level of structural risks. We consider above and below-median levels of the following structural risks: real estate exposure concentration (REL\_L), the leverage ratio (LR), private sector indebtedness (DEBT) and interest rates (IR). Specifically, we consider above-median levels of real estate exposure concentration and indebtedness and below-median levels of the leverage ratio and interest rates as a sign of a country having a high level of structural risk. We calculate the level of structural risks for each country as the average of the given indicator over the three-year window ahead of the start of our sample period in 2008Q3.<sup>15</sup> Detailed results are reported in Table 5 using the NPL ratio as the dependent variable.

Columns 1–4 in Table 5 show the regressions for those countries with high levels of structural risks prior to the starting date of our sample period. Columns 5–8 then report estimates for countries

<sup>15</sup> If data are not available for the full three-year window, we use the available data only, but we require at least three quarters ahead of 2008Q3. If we do not have observations for the data before 2008Q3, we exclude them from the analysis. This concerns Israel, Korea and the UK.

with low observed levels of structural risks.<sup>16</sup> In other words, we look at whether the relationship between structural risks and credit risk materialization remains the same, as long as some countries have previously high levels of structural risks and others have low ones. What we expect is greater significance and higher regression coefficients on the left-hand side of the table. Generally speaking, this is indeed the case. Higher levels of structural risks in the form of higher concentrations of real estate exposures, lower leverage ratios, higher private debt and a lower interest rate environment are generally associated with greater credit risk materialization.

We find the level of structural risks to be detrimental to the strength of the empirical relationship between credit risk materialization and structural risks. In line with the analytical discussion in the previous section, higher concentration of real estate exposures is found to be associated with an increase in the NPL ratio. This is, however, much more pronounced in countries where the levels of structural risks were already high prior to the outbreak of the GFC. On the other hand, the impact of an increase in real estate exposures in countries with low levels of structural risks is found to be statistically insignificant. The same is true for almost all the independent variables, regardless of the structural risk variables according to which the sample of countries is divided. If, on average, real estate exposures increased by 10 pp in a country that is not well capitalized (the second column), the NPL ratio would increase by 5.85 pp. This is approximately three times higher than our baseline estimates, where the level of structural risks was not taken into account (see Table 4 and the previous section).

Further, we find that lower capital and liquidity ratios are associated with higher NPLs, especially in countries with higher levels of private sector indebtedness prior to the GFC, but we find the relationship to be strong regardless of which structural risk is used as the splitting criterion. Higher risk weights are found to be associated with higher NPLs, especially for countries with high concentrations of real estate exposures and low capitalization. Similarly, high levels of government debt are associated with a higher NPL ratio, especially for countries with lower capitalization.

Last, we find an important role of the interest rate environment for the relationship between credit risk materialization and structural risks. We find that a decrease in interest rates in a country with unfavourable structural characteristics is found to be associated with a substantially higher NPL ratio. In another words, the evidence shows that post-crisis easing of monetary policy was less effective in reducing the default rate in countries with high levels of structural risks.

What is particularly interesting is the effect of the low interest rates seen before 2008 on the relationship between credit risk materialization and structural risks. Based on the emerging literature on the topic, we assume that low interest rates may amplify the negative impact of structural risks on credit risk (Bikker and Vervliet, 2018; Malovana et al., 2020; ESRB, 2021).

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<sup>16</sup> Table A4 in Appendix A shows the division of countries according to their levels of particular structural risks. In the sample, only Portugal was identified as a high structural risk country using all four criteria. Greece, Norway, Spain and Sweden were identified as high-risk countries in three out of the four criteria.

**Table 5: Empirical Link Between an Increasing NPL Ratio and the Level of Structural Risks**

Dependent variable: NPL ratio (upturns)	Higher level of structural risks				Lower level of structural risks			
	REL_L (1)	LR (2)	C_PNS (3)	3M IR (4)	REL_L (5)	LR (6)	C_PNS (7)	3M IR (8)
Private debt	0.034*** (0.008)	0.112** (0.053)	0.038 (0.028)	0.073*** (0.025)	0.061*** (0.016)	0.032*** (0.008)	0.053*** (0.009)	0.045*** (0.007)
Government debt	0.123** (0.050)	0.201*** (0.046)	0.132*** (0.043)	0.093** (0.047)	0.065*** (0.024)	0.037*** (0.014)	-0.004 (0.012)	-0.015 (0.010)
Real estate exposure	0.343*** (0.102)	0.585*** (0.222)	0.491*** (0.132)	0.420*** (0.085)	0.005 (0.044)	0.010 (0.025)	-0.012 (0.020)	-0.005 (0.031)
Liquidity ratio	-0.103*** (0.033)	-0.089 (0.241)	-0.168*** (0.045)	-0.154*** (0.032)	-0.037 (0.042)	0.007 (0.013)	-0.001 (0.011)	0.024 (0.026)
Bank-to-market ratio	0.346*** (0.070)	0.313*** (0.094)	0.305*** (0.101)	0.318*** (0.084)	-0.040 (0.043)	-0.052* (0.030)	-0.082** (0.033)	-0.023 (0.024)
Leverage ratio	-0.880 (0.992)	-0.777 (0.768)	0.019 (0.952)	-0.009 (0.810)	0.101 (0.185)	-0.513*** (0.197)	0.119 (0.198)	0.023 (0.136)
Risk weights	0.308** (0.120)	0.317** (0.151)	0.194** (0.097)	0.138** (0.064)	0.019 (0.029)	0.056* (0.032)	0.032 (0.031)	0.069* (0.029)
Interest rate	-0.415*** (0.112)	-0.384*** (0.109)	-0.398*** (0.157)	-0.590*** (0.064)	-0.053 (0.104)	-0.033 (0.098)	-0.083 (0.120)	0.045 (0.077)
Trade openness	0.251*** (0.063)	0.245*** (0.055)	0.205*** (0.045)	0.223*** (0.066)	0.053 (0.067)	0.033 (0.088)	0.083 (0.076)	0.045 (0.071)
Macro controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	413	295	378	463	436	440	435	418
adj. <i>R</i> <sup>2</sup>	0.528	0.536	0.508	0.515	0.370	0.237	0.325	0.353
F-test	15.226	13.524	17.677	14.818	11.304	10.278	12.597	12.913
	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***

**Note:** The dependent variable is the ratio of non-performing loans to total loans expressed as the period-to-period increases over the period 2008Q3–2019Q4. We consider four structural risk indicators used as a basis for splitting the sample: REL\_L = real estate concentration exposure, LR = leverage ratio, C\_PNS = private non-financial sector debt, 3M IR = interest rates. Robust standard errors in parenthesis. The constant was estimated but is not reported. Macro controls include real GDP growth and the rate of inflation. \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Columns 4 and 8 of Table 5 show the relationship between the individual structural risks and growth in the NPL ratio for countries with low and high pre-2008 interest rates. Generally, we find a positive correlation between structural risks and NPLs in countries with lower interest rates. In this respect, we confirm that higher indebtedness and real estate exposure concentration and lower banking sector resilience are associated with a higher NPL ratio, even more so in countries that kept their interest rates low before the GFC. A 10 pp increase in private debt is found to be associated with a 0.7 increase in the NPL ratio if rates were kept low, as compared to a 0.45 increase in the case of higher interest rates. In fact, we may expect the estimated coefficients to be quantitatively underestimated. The low-rate countries also have systematically higher levels of private debt (284% of GDP), so the unit change in private indebtedness is lower in low-rate countries than in high-rate ones (where private debt scales to only 193% of GDP).

## 6. Conclusion

The accumulation of structural risks is a phenomenon which, for a long time, was not a subject of general economic interest. Yet structural risks are an inherent part of systemic risk, alongside cyclical risk (Borio, 2003). In this paper, we collect a comprehensive set of various structural characteristics of the banking sector and the real economy for 30 advanced economies over the period 2006–2019. To capture the evolution of cyclical risk, we handcraft our own financial cycle indicator as well as using two well-established composite financial cycle indicators allowing for cross-country comparison.

We use our rich dataset to empirically analyse the relationship between cyclical and credit risk materialization and various structural risks. To account for the fact that individual financial cycles differ greatly, we focus on a narrow historical episode comprising a financial cycle peak and a subsequent bust. The period surrounding and following the Global Financial Crisis of 2007–2009 is a great candidate for empirical exploration. Using a turning point analysis, we first show that elevated levels of structural risks prior to the outbreak of a crisis are strongly correlated with the extent to which cyclical and credit risk materialize. Specifically, we unravel that countries with low banking sector resilience and high indebtedness experienced greater and longer materialization of cyclical risk. Second, we estimate a series of panel regressions that allow us to make causal conclusions on the relationship between cyclical risk materialization and structural risks. We specify our regressions in such a way as to reduce any endogeneity concerns, in particular reverse causality, which may be present.

We show that past accumulation of structural risks may influence the extent to which cyclical and credit risk materialize during financial cycle downturns. Among these risks, private and public sector indebtedness, banking sector resilience and concentration of real estate exposures stand out. Our estimates are robust to changes of the empirical specification and the choice of proxy variables. Furthermore, we show that elevated levels of structural risks prior to financial cycle contractions substantially amplify the materialization of credit risks and the financial cycle contraction itself. These results provide evidence of a fundamental property of some structural risks related to their potential to amplify adverse shocks.

We show that the elevated levels of some of the structural risks identified may be related to the long-standing accommodative economic policy, which restricts the natural materialization of accumulated systemic risk during financial cycle contractions. Given that many world economies have operated in such an environment for a prolonged period of time, the role of macroprudential policy can be expected to grow (Malovana et al., 2020; ESRB, 2021). In light of our empirical results, countries with high levels of selected structural risks should consider being more proactive in increasing capital buffers during the expansionary phase of the financial cycle. Although these macroprudential policy tools cannot significantly dampen the emergence of systemic risks, they can increase the resilience of the banking sector in situations where previously accumulated risks materialize.

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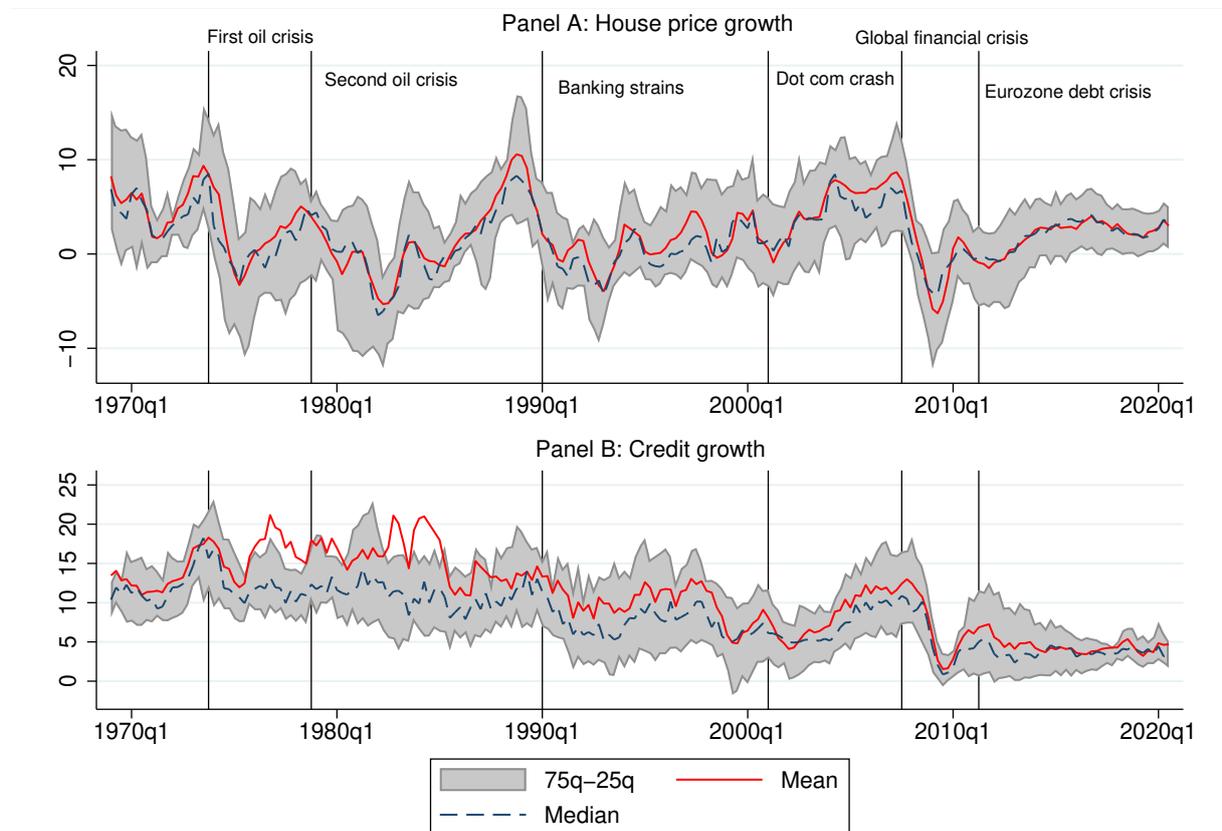
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## Appendix A: Details on the Data and the Sample of Countries

Figure A1: A Historical Overview of Cyclical Risks



**Note:** The underlying data were collected for a sample of 30 advanced economies.

**Source:** Bank for International Settlements database.

**Table A1: Mnemonics and Description of Our Variables**

Mnemonics	Description	Source
Assets/GDP	Total assets of the banking sector to GDP, per cent	FSI*
REL/L	Residential real estate loans to total loans, per cent	FSI
NPL/L	Non-performing loans to total loans, per cent	FSI
RW	Risk weights	FSI
C RWA	Regulatory capital to risk-weighted assets, per cent	FSI
LR	Tier 1 leverage ratio defined as bank's core capital relative to its total assets, per cent.	FSI
ROE	Return on assets, per cent	FSI
Liq/Assets	Liquid assets to total assets, per cent	FSI
3M IR	3-month interbank interest rate	OECD database
C NFS	Credit to non-financial sector to GDP, per cent	BIS statistical warehouse
C HH	Credit to households to GDP, per cent	BIS statistical warehouse
DSTI	Debt service to total income, per cent	FSI
C GOV	Credit to government to GDP, per cent	BIS statistical warehouse
C PNS	Credit to private non-financial sector, per cent	BIS statistical warehouse
Exp/GDP	Exports to GDP, per cent	WB database
FCL/L	Foreign currency loans to total loans, per cent	FSI
FinOpen	Financial openness index	Chinn and Ito (2006)
bank x market	Bank credit to private sector as ratio of GDP over sum of ratio of total non-financial sector debt market capitalization to GDP and ratio of stock market capitalization to GDP	WB(GFDD) and BIS
FCI	Financial cycle indicator	Aldasoro et al. (2020)
d-SRI	Domestic systemic risk indicator	Lang et al. (2019)
FinCyc	Financial cycle index	own calculation
GDP growth	Real GDP growth, per cent	OECD database

**Table A2: Descriptive Statistics of the Full Sample**

Variable	N	Mean	St. Dev.	Min	Pctl(25)	Pctl(75)	Max
Assets/GDP	1,306	211.855	124.534	0.36.366	80.917	109.542	281.598
REL/L	1,034	27.354	12.253	2.385	18.684	34.389	63.773
NPL/L	1,320	4.774	6.420	0.146	1.472	4.578	47.196
RW	1,062	51.903	17.492	15.165	35.546	67.495	94.767
C RWA	1,335	16.137	3.271	8.093	13.940	17.975	27.493
LR	1,033	7.968	3.250	1.372	5.591	10.035	17.512
ROE	1,333	9.216	9.999	-85.351	3.984	15.445	38.262
Liq/Assets	1,199	24.622	14.590	4.284	13.862	30.360	84.247
3M IR	1,334	1.387	1.918	-0.839	0.049	2.012	10.534
C NFS	1,380	241.490	85.634	49.100	188.075	297.225	510.700
C HH	1,380	64.986	30.874	12.300	40.800	87.425	137.900
DSTI	1,058	16.860	6.516	3.300	12.900	20.800	32.700
C GOV	1,380	68.388	42.018	4.200	35.675	86.725	205.200
C PNS	1,380	169.012	75.429	28.700	113.325	215.325	413.500
Exp/GDP	1,380	49.029	38.772	9.791	29.187	57.585	273.907
FCL/L	912	21.196	13.165	0.848	11.097	27.830	61.198
FinOpen	1,380	1.633	0.698	-1	2	2	2
bank x market	1,380	0.321	0.108	0.031	0.246	0.386	0.618
FCI	1,168	0.010	0.144	-0.358	-0.082	0.096	0.366
d-SRI	570	-0.135	1.307	-6.450	-0.738	0.337	11.211
FinCyc	1,062	-0.016	0.513	-2.234	-0.316	0.258	1.769
GDP_growth	1,380	1.680	3.174	-12.934	0.555	3.031	28.960

**Table A3: Materialization Phases of Cyclical Risk Identified**

Country/Episode	Materialization episodes					
	1		2		3	
	value	duration	value	duration	value	duration
Australia	8.593	6	12.372	8		
Austria	14.911	15	8.343	7		
Belgium	14.655	7	1.706	5		
Canada	6.261	6	2.152	6	5.198	7
Chile	13.764	9	6.846	9		
Colombia	1.322	7	1.636	12		
Czechia	14.915	16	9.286	10		
Denmark	6.880	6	6.404	6		
Finland	18.702	7	2.880	8	9.529	6
France	19.955	7	11.179	7	5.095	6
Germany	8.918	6	13.051	7		
Greece	11.826	6	60.370	27		
Hungary	3.330	7	1.862	6		
Ireland	8.244	8	2.874	6	4.540	5
Israel	9.157	6	4.682	6	2.373	5
Italy	10.372	6	29.408	14		
Japan	26.682	7	13.222	8		
Korea	14.511	9	10.522	9		
Luxembourg	9.221	5	17.440	20		
Mexico	14.654	7	9.019	6	8.757	5
Netherlands	13.558	7	10.947	8	3.563	4
New Zealand	4.684	6	12.560	11	5.908	6
Norway	4.958	6	2.793	8	6.942	7
Poland	10.334	6				
Portugal	33.770	11	3.796	5		
Spain	13.153	7	21.082	12		
Sweden	21.819	8	21.144	13		
Switzerland	28.401	14	15.608	7	13.236	12
United Kingdom	15.924	7	8.543	7		
United States	42.746	13	4.397	7		
<b>max</b>	<b>42.746</b>	<b>16</b>	<b>60.370</b>	<b>27</b>	<b>13.236</b>	<b>12</b>
<b>min</b>	<b>1.322</b>	<b>5</b>	<b>1.636</b>	<b>5</b>	<b>2.373</b>	<b>4</b>
<b>mean</b>	<b>14.207</b>	<b>7.9</b>	<b>11.246</b>	<b>9.1</b>	<b>6.514</b>	<b>6.3</b>

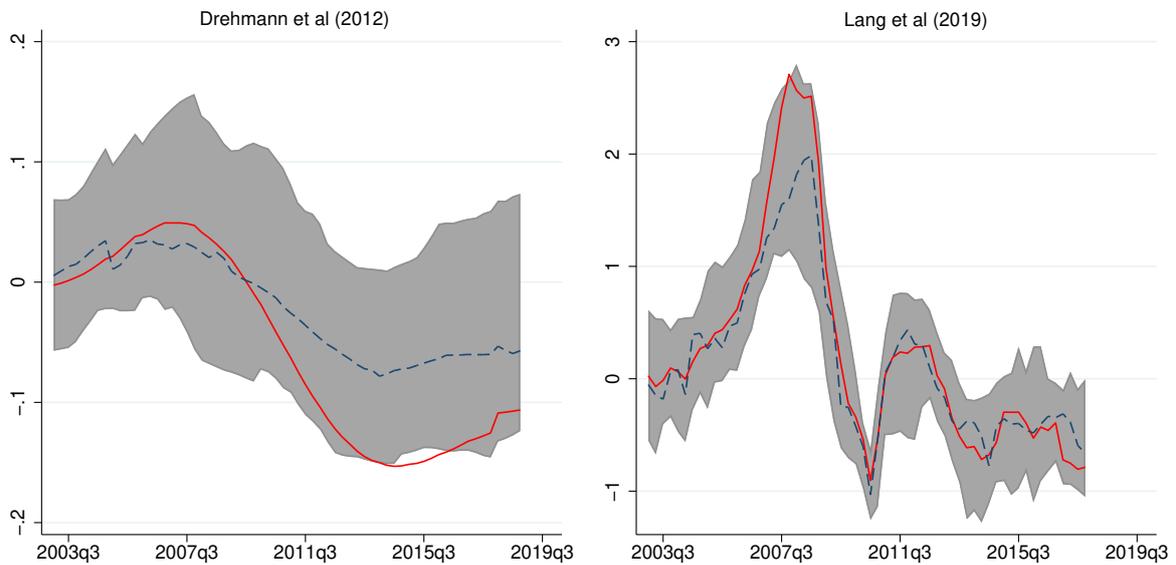
*Note:* The table shows the estimated amplitude of cyclical risk materialization. The amplitude measures the change in the financial cycle indicator from a local maxima to the nearest local minima multiplied by the number of quarters between the minimum and maximum points (duration). The higher the amplitude, the longer and more intense the cyclical materialization was. We identified a maximum of three cyclical risk materialization episodes per country.

**Table A4: Sample Split According to the Level of Individual Structural Risks**

Country/Split indicator	REL_L	LR	DEBT	IR
Australia	x			
Austria		x		x
Belgium			x	x
Canada	x			
Colombia		x		
Czechia	x			x
Denmark	x		x	
Finland	x			x
France			x	x
Germany				x
Greece		x	x	x
Hungary		x		
Chile		x		
Ireland			x	x
Israel				
Italy			x	x
Japan			x	x
Korea				
Luxembourg			x	x
Mexico		x		
Netherlands			x	x
Norway	x	x	x	
Poland	x	x		
Portugal	x	x	x	x
Spain	x		x	x
Sweden	x		x	x
Switzerland			x	x
Turkey		x		
United Kingdom				
United States	x	x		

**Note:** The table shows how we split the individual countries into two groups – countries with a heightened level of the selected structural risk indicator (above-mean) and the rest. We consider four structural risk indicators used as a basis for splitting the sample: REL\_L = real estate concentration exposure, LR = leverage ratio, C\_PNS = private non-financial sector debt, 3M IR = interest rates.

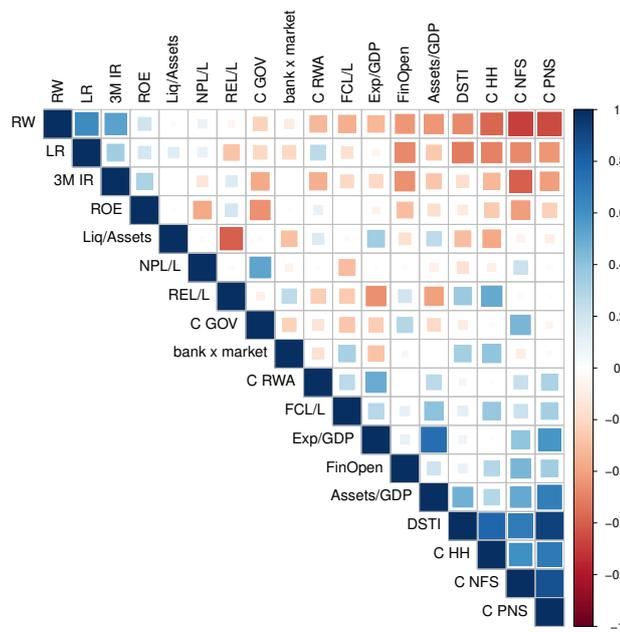
**Figure A2: Alternative Measures of Cyclical Risk**



**Note:** Drehmann et al. (2012) provided us with the Financial Cycle Index and Lang et al. (2019) with the Domestic Cyclical Risk Indicator. The shaded region marks the area between the first and third quantile of the cross-country distribution. The solid red line denotes the mean and the dashed blue line the median.

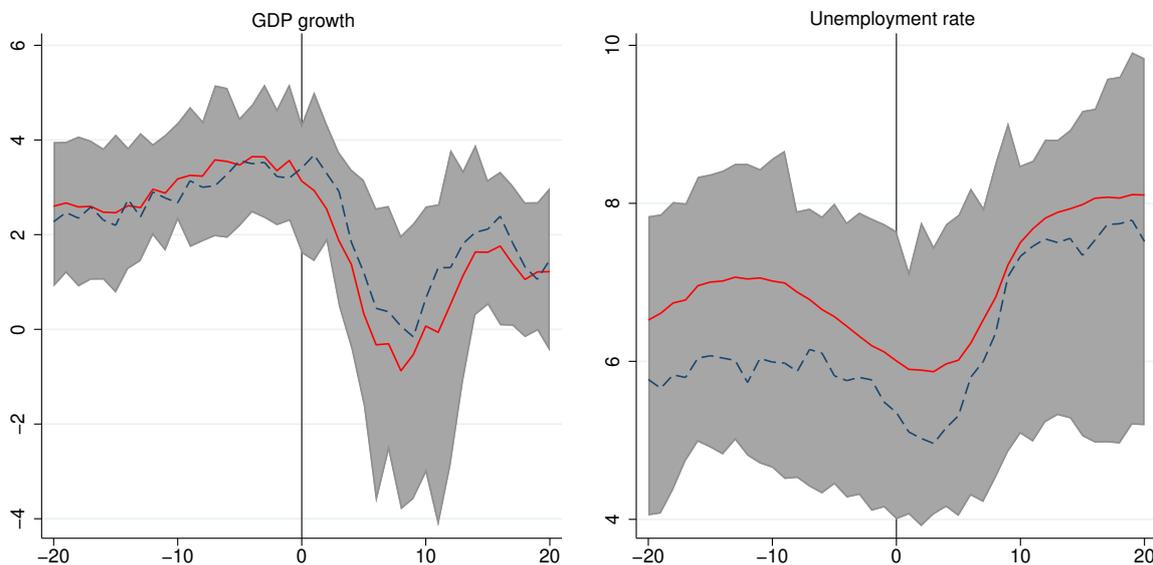
**Source:** Aldasoro et al. (2020), Lang et al. (2019), own computation.

**Figure A3: Correlation Matrix for Structural Risks**



**Note:** We used the first principal component (FPC) order as the ordering method for the correlation matrix. The matrix should therefore show clusters of structural risks that are similar and emerge together.

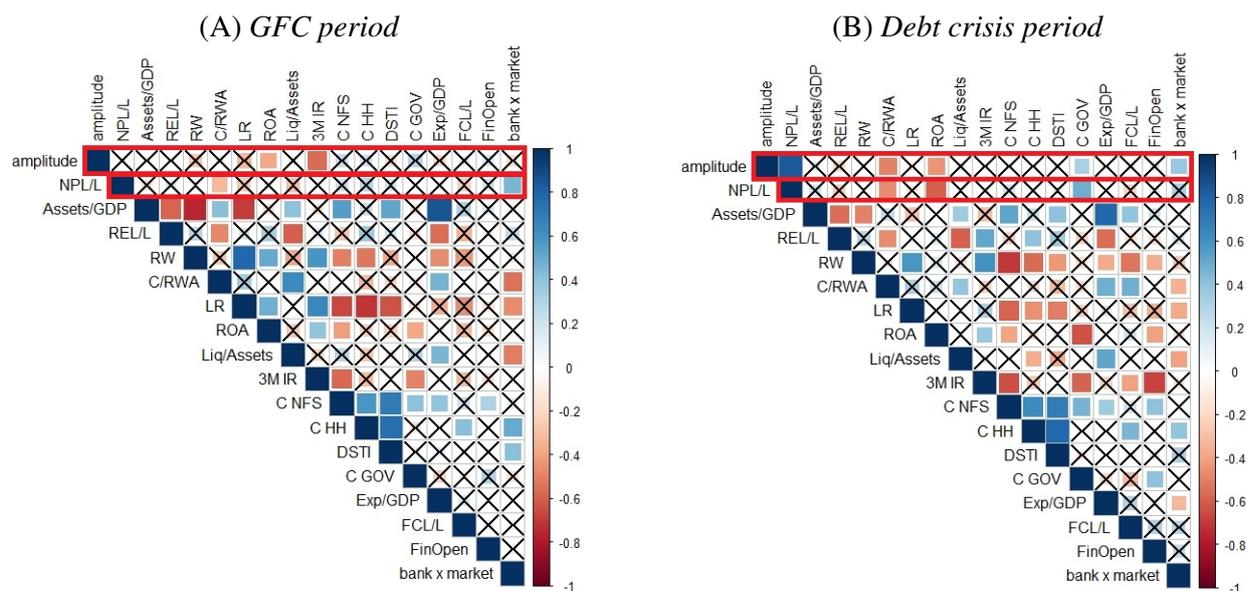
**Figure A4: Cross-country Distribution of Real GDP Growth and Unemployment Changes Around the Start of the Cyclical Risk Materialization Phase**



**Note:** The shaded region marks the area between the first and third quartile of the cross-country distribution. The solid red line denotes the mean and the dashed blue line the median.

**Source:** Own computation.

**Figure A5: Correlation Matrices for Financial Cycle Amplitude and Individual Structural Risks**



**Note:** Both correlations are based on the START approach, the same as the correlations in Panel A of Figure 4. Crossed fields denote a statistically insignificant correlation coefficient at the 5% level as evidenced by t-statistics.

**Source:** Own computation.

## Appendix B: Additional Estimates

**Panel Granger causality.** To detect panel Granger causality, we follow the Dumitrescu and Hurlin (2012) procedure, which consists in estimating the following heterogeneous panel data models:

$$Cyclical_{it}^{mat} = \tau_i + \sum_{j=1}^p \gamma_{ij} Cyclical_{it-j}^{mat} + \sum_{j=1}^p \lambda_{ij} Structural_{it-j} + \varepsilon_{it}, \quad (B1)$$

$$Structural_{it} = \tau_i + \sum_{j=1}^p \eta_{ij} Structural_{it-j} + \sum_{j=1}^p \kappa_{ij} Cyclical_{it-j}^{mat} + \mu_{it}, \quad (B2)$$

where  $Structural_{it-j}$  indicates the past values of structural risks,  $p$  is the lag order, which is assumed to be identical for all panel units, and  $\eta$  and  $\mu$  are the error terms, which are assumed to be well-behaved. The test of the null hypothesis that structural risks do not Granger-cause cyclical risk materialization in Eq. B1 and that cyclical risk materialization does not Granger-cause structural risks in Eq. B2 is based on the standardized average Wald statistics proposed by Dumitrescu and Hurlin (2012), denoted as  $\bar{Z}$  and  $\check{Z}$ . For a panel with large T and small N, as in our case,  $\bar{Z}$  is preferred to  $\check{Z}$ . We set a lag order of four quarters to be consistent with the lag used in the baseline Eq. 4.

**Table B1: Panel Granger Causality**

Causality direction	NPL ratio		ROE	
	$\bar{Z}$	$\check{Z}$	$\bar{Z}$	$\check{Z}$
$REL\_L \rightarrow Cyclical_{it}^{mat}$	7.181***	5.809***	0.372	-0.012
$Cyclical_{it}^{mat} \rightarrow REL\_L$	1.847*	1.249	0.034	-0.301
$C\_GOV \rightarrow Cyclical_{it}^{mat}$	6.284***	5.042***	5.012***	3.955***
$Cyclical_{it}^{mat} \rightarrow C\_GOV$	1.254	0.833	0.301	-0.073
$C\_NFS \rightarrow Cyclical_{it}^{mat}$	2.793***	2.057**	3.266***	2.462**
$Cyclical_{it}^{mat} \rightarrow C\_NFS$	1.217	0.710	0.575	0.161
$C\_HH \rightarrow Cyclical_{it}^{mat}$	4.932***	3.887***	0.188	-0.169
$Cyclical_{it}^{mat} \rightarrow C\_HH$	1.296	0.777	0.533	0.124
$C\_PNS \rightarrow Cyclical_{it}^{mat}$	3.700***	2.833**	2.277**	1.616
$Cyclical_{it}^{mat} \rightarrow C\_PNS$	1.436	0.897	1.557	1.001
$C\_RWA \rightarrow Cyclical_{it}^{mat}$	4.041***	3.124***	2.716***	1.991**
$Cyclical_{it}^{mat} \rightarrow C\_RWA$	3.867***	2.975**	1.132	0.637
$LIQ\_ASSETS \rightarrow Cyclical_{it}^{mat}$	1.777*	1.188	-0.689	-0.920
$Cyclical_{it}^{mat} \rightarrow LIQ\_ASSETS$	-1.427	-1.551	1.033	0.552
$BANKMARKET \rightarrow Cyclical_{it}^{mat}$	5.347***	4.241***	1.979**	1.361
$Cyclical_{it}^{mat} \rightarrow BANKMARKET$	1.371*	0.551	-0.710	-0.793
$LR \rightarrow Cyclical_{it}^{mat}$	2.261**	1.602	2.248**	1.591
$Cyclical_{it}^{mat} \rightarrow LR$	2.860**	2.114**	1.886*	1.281
$RW \rightarrow Cyclical_{it}^{mat}$	3.818***	2.934**	3.737***	2.864**
$Cyclical_{it}^{mat} \rightarrow RW$	0.223	-0.140	-0.162	-0.470

**Note:** \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . The test was performed using a lag order of 4. The stationarity of the variables was verified by the Levin-Lin-Chu unit-root test, which is suitable for panels with a substantially larger number of time periods than panel units. For all the variables, the test rejects the null hypothesis that the panels contain unit roots.

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